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STATE FOR EAP/CM, NEA/IR AND E DNELSON, NSC FOR TONG AND WILDER, TREASURY FOR OFAC

E.O. 12958: DECL: 02/14/2018
TAGS: ECON EFIN HK IR
SUBJECT: HKEX PROFITS/AVOIDS POLITICAL RISK IN SEARCH FOR NEW BUSINESS

Classified By: Acting EP Chief, Jim Mullinax, Reason 1.4 b/d

¶1. (C) Summary: The Hong Kong Stock Exchange (HKEx) enjoyed it's most profitable year ever in 2007, buoyed by fees from dramatically increased trading volumes. Although total value of funds raised through initial public offerings (IPOs) fell from the record levels of 2006, the total number of IPOs increased. HKEx has been aggressively pursuing listings from overseas companies, focusing marketing attention on Japanese, Korean, Russian, and Vietnamese companies, but HKEx corporate governance and transparency requirements make it difficult for some companies to seek Hong Kong share listings. HKEx Executive Vice President Lawrence Fok said a recent visit from the Tehran Stock Exchange (TSE) will not lead to any expanded cooperation or business, given the obvious political risks for HKEx of engaging with Iranian counterparts. End Summary.

¶2. (C) Comment: While HKEx publicly welcomes any company capable of meeting Hong Kong's strict listing requirements, senior management is eager to avoid listings that might derail its goal of becoming the premiere Asian Financial Center. HKEx routinely meets with delegations from foreign stock exchanges to provide information and, less frequently, signs MOUs to provide information and cooperate on training. Fok dismissed these MOUs as "PR exercises" rather than substantive opportunities for cooperation. HKEx leadership understands that an MOU with the Tehran Stock Exchange is not the kind of PR they are seeking. End comment.

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High Volume, not IPOs, drives HKEx 2007 Profits
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¶3. (U) HKEx enjoyed a banner year in 2007 due to an exponential increase in trading volumes. HKEx Executive Vice President Lawrence Fok noted that average daily equity trading volumes in Hong Kong have increased from US$2.5 billion in 2005 to US$4.4 billion in 2006, and averaged over US$11 billion in 2007. The large jump in volume in 2007 was driven in part by investor expectations that the Chinese government would approve Chinese retail investors direct participation in Hong Kong's stock market (the "through train" scheme). Futures and options demand has increased apace. Increased demand for shares pushed the Hang Seng Index to a record high of 31,638 at the end of October 2007 before share prices fell back sharply on concerns about financial sector exposure to sub-prime loans and the health of the U.S. economy. The Hang Seng Index closed February 14, 2008 at 24,021. Hong Kong market capitalization peaked in 2007 at over US$2.9 trillion.

¶4. (U) Although the "through train" has been delayed indefinitely by Chinese regulators, investors, both foreign and domestic remain active in the Hong Kong market. Fok expects trading volume to increase again in 2008 and is confident that the HKEx trading system can easily handle double the current volume of trades without additional technical upgrades. HKEx profits, which had increased by 88% from 2005 to 2006 (US$320 million), appeared set to more than double again in 2007 with profits through three quarters of 2007 already surpassing US$564 million.

¶5. (U) In 2006, Hong Kong was the global leader in funds raised through IPOs. Newly listed firms raised almost US$44 billion in 59 IPOs, with Chinese banking behemoths ICBC and Bank of China alone raising over US$27 billion. Chinese companies (both state-owned and privately held) dominated Hong Kong's IPO market in 2006, accounting for over 90% of total funds raised. HKEx continued to target Chinese companies for share listings, but 2007 held no mega-offerings in Hong Kong comparable to the Chinese banking IPOs of the previous year.

¶6. (U) HKEx hosted a record number of IPOs in 2007 (86 new listings), although the value of funds raised fell short of 2006 levels reaching just US$39 billion. China CITIC Bank, Chinese property developers Country Garden and Sino-Ocean Land, Chinese retailer Sichuan Xinhua Winshare, and Chinese internet company Alibaba.com were the hot Hong Kong IPOs in ¶2007. Fok explained that many Chinese firms preferred to list in Shanghai to take advantage of higher Price/Earnings (PE) ratios, and that Shanghai had surpassed Hong Kong in total funds raised in 2007, but noted that Hong Kong remains the best platform for Chinese companies to raise foreign

exchange and avoid Chinese capital controls.

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HKEx Must Diversify to be the Asian Financial Center
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¶7. (U) While HKEx officials are pleased to be the bourse of choice for Chinese companies seeking international equity listings, senior leaders see diversification as essential to their goal of becoming Asia's premier international financial exchange. HKEx recently announced its plans to develop an emissions trading platform and to introduce trading in gold-related structured products. HKEx sees increasing the geographic diversity of listed companies as integral to their plan to become the Asian Financial Center. A number of Taiwan and Vietnamese companies are already listed on the HKEx, including ten new listings in 2007. HKEx management has traveled to Russia, Japan, South Korea, India and Southeast Asia to encourage companies to consider listing on the Hong Kong exchange.

¶8. (U) In December 2007, HKEx signed MOUs to expand cooperation with stock exchanges in Mongolia and Ho Chi Minh City, Vietnam. While many companies have expressed interest in a Hong Kong listing, HKEx's strict governance and transparency requirements pose obstacles for some, causing them to look to Singapore or other bourses with less stringent listing protocols. When asked about the possibility of tapping cash-rich Middle Eastern countries, Fok replied that HKEx is not actively looking at listing Middle Eastern companies right now, citing limited prospects for trading these shares in Hong Kong.

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But Political Problems Are Not Welcome
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¶9. (C) Fok acknowledged that HKEx management had met with representatives from the Tehran Stock Exchange (TSE) and Iranian Bourse organization in January. However, he denied

that the meetings were substantive, despite Iranian press reports that the two sides had discussed signing an MOU to cooperate in training programs, information exchange, and the development of Islamic financial markets. Without significant support from financial intermediaries, which is clearly lacking, HKEx would not be interesting in signing an MOU with TSE, he said.

¶10. (C) When asked about the possibility of Iranian companies, state-owned or privately held, listing in Hong Kong, Fok replied that the HKEx welcomes companies able to meet its strict listing requirements. But senior HKEx leadership would not welcome companies with "political problems" that could derail HKEx's plans to become the premiere Asian financial center. The risks to HKEx's reputation outweigh any potential benefits to the HKEx at this time. If those political problems were resolved, said, Fok, HKEx would be happy to consider qualified Iranian companies, but the current environment makes an Iranian listing in Hong Kong difficult to imagine.
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